No. 2773

In the United States Circuit Court of Appeals

For the Ninth Circuit

MAINE NORTHWESTERN DEVELOPMENT COMPANY, a Corporation,

Appellant,

vs.

NORTHWESTERN COMMERCIAL COMPANY, a Corporation,

Appellee.

BRIEF ON MOTION TO DISMISS APPEAL FOR WANT OF JURISDICTION.

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LAWRENCE BOGLE,
Seattle, Washington.

SHERMAN PRINTING & BINDING CO., SEATTLE, WASH.

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This is an action at law commenced by the appellant, plaintiff below, in the District Court of the United States, for the Western District of Washington, in March, 1912, to recover from the defendant and appellee the sum of $125,000, alleged to be due to the plaintiff and appellant from the defendant upon

an alleged agreement of subscription for preferred shares of stock in the plaintiff company. The subscription agreement is attached as an exhibit to the complaint, and was signed in the name of the defendant company, by John Rosene, president. An amended complaint was filed in the case on July 30, 1915, and an amended answer to this complaint was filed in September, 1915. The case came on for trial in December, 1915, and resulted in a verdict of the jury in favor of the defendant, and judgment was accordingly entered on December 5, 1915. No bill of exceptions was ever settled nor writ of error taken out from this court, the plaintiff seeking a review by appeal under the Act of Congress of March 3, 1915, upon the theory that an equitable defense was interposed by the amended answer. The act of March 3, 1915, provides that "the review of the judgment or decree entered in such case shall be regulated by rule of the court." So far as we have been able to ascertain, no rule of court has been adopted regulating the procedure in taking an appeal to review an action at law.

I.

There was no equitable defense interposed in this action. The original complaint was filed in March, 1912. The amended complaint, filed July 30, 1915, alleges that the plaintiff corporation was incorporated expressly for the purpose, among others, of purchasing

from Rosene certain mining claims and water rights in Alaska, to be paid for by the issuance of $3,750,000 par value of its common stock, and $245,000 in cash. It further alleges that the plaintiff was incorporated March 17, 1906, and that it purchased from Rosene these mining claims and water rights on March 20, 1906, and issued its common shares of stock therefor, and thereafter paid Rosene the sum of $245,000 in cash. The subscription sued on is alleged to have been made by Rosene on behalf of this defendant for the preferred stock of the defendant company on April 4, 1906.

The first affirmative defense in the amended answer to the amended complaint, which is the defense claimed by appellant to be an equitable defense, alleges in substance as follows: That the John Rosene mentioned in the amended complaint was one of the promoters and the managing director of the plaintiff; that he had entered into certain contracts with certain other promoters of the plaintiff, and with the plaintiff, whereby it was agreed, among other things, that said Rosene and his associate promoters would organize plaintiff corporation; that said Rosene and certain other persons were the owners of the said mining claims, which said claims were alleged to have been of little value and which they were desirous of selling, and it was agreed between said Rosene and his associate owners of said mining property and the other

promoters of the plaintiff corporation that when said corporation was organized, the said mining property would be conveyed to said Rosene by the other parties interested therein, and that said Rosene would thereupon convey said mining property to the plaintiff corporation, and should be paid therefor, in full payment for said property, the sum of $245,000; that $1,250,000, par value of the capital stock of plaintiff corporation, known as common stock, should be issued to Rosene, ostensibly as a part payment for said property, but in reality as a bonus and gift to said Rosene and the other promoters of plaintiff corporation; that it was further understood and agreed and was a part of the same arrangement that Rosene would provide the money, to-wit, the $245,000, to be paid to himself for said mining property, by subscribing for preferred shares of the plaintiff corporation on behalf of this defendant, to the amount of $250,000, and that the money realized on such subscription should and would be appropriated by the plaintiff company to the payment to said Rosene of said $245,000; and it is alleged that said subscription, on behalf of the defendant referred to in the complaint, was made by Rosene and accepted by the plaintiff company pursuant to this agreement and understanding by him with said plaintiff and its promoters, and in furtherance thereof and of his own personal interests and of those of said other promoters, and not otherwise.

It is further alleged that after the organization of the plaintiff corporation, it and its officers and directors had full knowledge of these facts, understandings and agreements, and that plaintiff became a party thereto; that said subscription on behalf of this defendant was accepted by the plaintiff with full knowledge of all these facts, and that pursuant to said agreement the said common stock of plaintiff was issued by plaintiff to said Rosene and his co-promoters.

It is further alleged that this defendant did not authorize nor approve said subscription, and was ignorant of the secret understandings, agreements and interests of said Rosene until it acquired knowledge thereof during the years 1910 or 1911.

It is further alleged that at a meeting of the Board of Trustees of the defendant company in April, 1906, at which said Rosene was present, when said defendant was first notified that said Rosene had made said alleged subscription, the Board of Trustees immediately repudiated the same, and verbal notice thereof was immediately thereafter given to the plaintiff corporation through its president and treasurer.

It is further alleged in the defense that the defendant, on various other occasions thereafter, whenever the matter of this subscription was mentioned or brought before it, consistently and persistently repudiated the same and disclaimed any liability thereunder.

The defense further alleges that Rosene did convey the mining claims to the plaintiff, pursuant to the agreements and understandings above set out, and that Rosene, without the knowledge or consent of the defendant, caused moneys of the defendant, aggregating $125,000, to be turned over to the plaintiff on said alleged subscription, and that the plaintiff, pursuant to said understandings and agreements, turned over said money, or a large part thereof, to the said Rosene.

It will be noticed that this plea alleges that when Rosene signed the subscription agreement on behalf of this defendant, on April 4, 1906, he was (a) president of the defendant company; (b) promoter and managing director of the plaintiff company; (c) vendor of the mining claims to plaintiff and as such a personal creditor of the plaintiff in the sum of $245,000, which plaintiff agreed to pay out of this subscription; (d) party to a conspiracy with his associate promoters to secure $1,250,000 of the common stock of the plaintiff without consideration to plaintiff therefor; and (e) party to an agreement with the promoters of the plaintiff, and with the plaintiff itself, that he would make this subscription on behalf of this defendant in order to provide the money with which plaintiff was to make payment to him for the mining claims conveyed by him to it.

The defendant is a Washington corporation, and under the laws of that state, the corporate powers of

the corporation must be exercised by the Board of Trustees (2 Rem. & Bal. Code, §3680). Rosene, therefore, clearly had no authority to make this subscription on behalf of the defendant without authorization from its Board. The plea alleges that no such authority had been given. Consequently the subscription was not binding upon the defendant unless it ratified or adopted Rosene's unauthorized contract. The plea in question, however, expressly alleges that the defendant not only did not authorize or ratify or adopt the unauthorized contract, but on the contrary, immediately repudiated it, as soon as it had knowledge that Rosene had attempted to make it. We cannot understand on what theory the defense, in this aspect of it, can be regarded as an equitable defense. If A, without authority, enters into a contract on behalf of B, with a third person, the contract has no binding effect whatever. *A fortiori,* if B. seasonsably repudiates it, it has no legal existence or binding force. That, in substance, is the case here as alleged in this special defense.

We are not now dealing with the question of the sufficiency of the defense, nor testing it under a demurrer. It may be that the facts alleged could have been proven under the general issue and that they amount merely to the plea of *non est factum.* The sole question here is whether the defense is equitable, not whether it is sufficient or well pleaded. It was deemed

good pleading to set out the repudiation and the facts which gave defendant the right to repudiate the contract, even though the facts might have been admissible under the general issue.

Cummins vs. Boyd, 83 Pa. St., 372.

If Rosene, simply as president of the defendant company, could be held to have implied power or authority to enter into this contract on its behalf, the facts pleaded show such relationship by him to the other party to the contract and such an interest in the subject matter of the contract adverse to his principal as to disqualify him from acting in this matter as the agent of or on behalf of this defendant. We believe the rule is universal, that an agent will not be permitted to contract on behalf of his principal in a matter wherein his personal interest is adverse to his principal, unless the principal, with full knowledge of his interest and relations, sees fit to approve or ratify the contract; in other words, a contract made by an agent, which otherwise would be within the scope of his authority, is not binding upon the principal without adoption or ratification after full knowledge, where the agent has a personal interest in the subject-matter of the contract adverse to the principal. We are not now concerned with the question of an innocent third party, because the plea alleges that plaintiff had full knowledge of all the facts.

Whether such a contract is absolutely void or merely voidable is immaterial, because considering it as voidable, it becomes a nullity upon prompt and timely repudiation by the principal.

"The right of a principal to refuse to be bound by a transaction in which the agent assuming to represent him has an adverse interest is unconditional. It is immaterial whether the transaction was fair to the principal or not. The incapacity of the agent to act in a case of this kind results from an *implied limitation of the authority delegated by the principal*, and this limitation is implied in all cases because sound policy obviously demands that an agent should never be led into the temptation of placing his interest in conflict with his duty. In many cases it would be impossible to ascertain whether the agent did or did not obtain the best terms for the principal which it was possible to obtain; but the principal would always have the privelege of adopting the contract made on his behalf if he should desire, and ratification usually would be implied in a case of this kind upon a failure to dissent."

1 *Mor. on Corp.*, §522.

This doctrine was recognized by this court in *Cowell vs. McMillan*, 177 Fed. 25, as founded on good morals and sound public policy. The principle was also recognized and applied in *Mooney vs. Mooney Co.*, 71 Wash., 258. In *Parsons vs. Co.*, 25 Wash., ——, the court carried the doctrine to the extreme by holding that a trustee of a Washington corporation was so far disqualified by adverse interest that he could not be counted as present for the purpose of making a quorum of the Board, and that any action of the Board, when there was no quorum without counting him, was void.

In *Twin Lake Oil Co. vs. Marbury,* 91 U. S., 587, the corporation executed a note and mortgage to a director. The court held that the corporation could have rescinded or avoided the contract simply because of the relation of the payee of the note and mortgage to the corporation, if it had seen fit to do so promptly. It further held that as the corporation executed the note and mortgage, they were not void but voidable; and inasmuch as the director in that case had acted openly, in good faith, and with the full knowledge of the corporation, and the corporation had received and used the money advanced on the note, it was estopped thereafter to repudiate.

A case similar in principle to the one at bar is that of *City of Findlay vs. Pertz,* 66 Fed., 427. In that case one B, who was agent for P. & S. for the sale of gas machines, entered the employ of the city as superintendent of its gas works, and as such superintendent in the city's name ordered from P. & S. certain gas machines, upon which he received from P. & S. a commission of $10.00 upon each machine. The city officials had no knowledge of such commission and double agency. The machines were received by the city and installed and used and part of the price paid. Afterwards, when learning of the double agency of the superintendent, the city gave notice of repudiation of the contract of purchase and offered to return the machines, but did not, in fact, reship them. Action

was brought at law by P. & S. against the city for the balance of the purchase price. The answer set up the facts above stated as a defense. Judge Lurton, in delivering the opinion for the Circuit Court of Appeals, says:

"Any agreement or understanding between one principal and the agent of another, by which such agent is to receive a commission or reward if he will use his influence with his principal to induce a contract or enter into a contract for his principal, is pernicious and corrupt, and cannot be enforced at law."

"Such agreements are a fraud upon the principal which entitle him to avoid a contract made through such agency. * * * Where there are a principal, an agent and a third party contracting with the principal and cognizant of the agent's employment, and there are dealings between the third party and the agent which give the agent an interest against his duty, then the principal, on discovering this, has the option of rescinding the contract altogether. *Wald's Pol. Cont., 247.*"

The learned judge pointed out the difference between the effect of the double agency upon the contract between the third party and the agent for the reward, and its effect upon the contract between the third party and the principal—holding that the principal, upon discovery of the facts, might either repudiate or affirm the contract. He further held that if the principal repudiated the contract and his repudiation was timely, the third party could not recover against him, either at law or in equity. In that case the trial court held that the city, by retaining the gas machines, had waived its right to repudiate the contract. The Circuit Court

of Appeals reversed the case and remanded it with instructions to submit the question of the sufficiency of the repudiation of the contract to the jury.

That case is direct authority for the proposition that a contract made by the agent for his principal, when the agent is adversely interested, may be repudiated by the principal, and that upon a suit at law by a third party against the principal on the contract, the defense showing the adverse interest of the agent and timely repudiation is a legal defense and not equitable.

In the case of *Pac. Lbr. Co. vs. Moffett*, 134 Fed. 836, a similar defense at law was sustained.

As above stated, in many of the cases it is held that the adverse interest of the agent disqualifies him from acting in that matter on behalf of his principal, even though the matter otherwise would be within the scope of his agency; and that where the third party has notice of the adverse interest of the agent, that is notice of lack of authority on the part of the agent to enter into the contract. (I. Mor. on Corp., Sec. 524.)

Story on Agency, Section 210.
II Corpus Juris, Section 519, and cases there cited.
Dowden vs. Cryder, 55 N. J. L., 329.
O'Meara vs. Lawrence, 141 N. W., 312.
Park Hotel Co. vs. Bank, 86 Fed., 742.
National Bank vs. Bank, 95 Fed., 87.
Christy vs. Foster, 61 Fed., 551.

In 10 Cyc., 912, the rule is thus stated:

"Subject to exceptions in favor of innocent parties, the general rule is that acts of officers of a corporation in any transaction in which both the corporation and they themselves individually are interested, do not bind the corporation."

Thus, in *Glover vs. Ames,* 8 Fed., 351, it was held that on a sale made by an agent who had a personal interest adverse to his principal, which was known to the purchaser, no title passed; and in *Clafflin vs. F. & C. Bank,* 25 N. Y., 293, a note executed by the officer of the bank, payable to himself, was held to be void, the fact that the officer was payee being notice to the world that his interest was adverse to the principal for whom he was undertaking to act. In the case at bar, actual knowledge of the adverse interest of the agent is alleged.

The same rule is applied in *National Bank vs. Munger,* 95 Fed., 87, and in *Stephens vs. Gall,* 179 Fed., 938.

In Meechem on Agency, section 66, the rule is stated as follows:

"A person will not be permitted to take upon himself the character of an agent where on account of his relation to others or on account of his own personal interest, he would be compelled to assume incompatible and inconsistent duties and obligations. An agent owes to the principal a loyal adherence to his interests, and it would be a fraud upon the principal and would contravene the public policy to permit an agent, without the full knowledge and consent of his principal, to enter into a relation involving such a duty when his allegiance had already been pledged to one having

adverse interests or when his own personal interests would be antagonistic to those of his principal."

In the case at bar, the plea in substance shows that the execution of this subscription contract by Rosene was part of a scheme and conspiracy entered into between Rosene and his associates, and the plaintiff itself, for the purpose of getting the moneys of the defendant to pay Rosene for his mining property. Manifestly, Rosene, being the vendor of mining claims of little value (as alleged in the pleading), but which he was selling for $245,000, was not in a position to give the defendant the benefit of his sound judgment as to the advisability of subscribing to stock in the plaintiff corporation, when the fruits of such subscription constituted the only means of securing payment for his mining claims. The very money which was to be realized on that subscription was part of the reward expected to be reaped by Rosene as a result of the consummation of the scheme.

It has been the contention of appellant that this was an equitable defense within the principle applied by this court in the case of *Hill vs. N. P. Ry. Co.,* 113 Fed., 914, and *Standard Portland Cement Corporation vs. Evans,* 205 Fed., 1. In these cases this court has held that where a contract is executed understandingly and intentionally, but the party was induced to enter into the contract by false or fraudulent representations, the defense on that ground is not available at law.

Those cases are not applicable to the defense presented in the case at bar. Where the contract sued upon was understandingly and intentionally executed by the party being sued, it may well be that only equity has jurisdiction to annul and set aside such contract because of collateral fraud practiced upon the defendant as an inducement to move him to execute the contract. In the case at bar, however, under the facts pleaded in this defense, the contract was never executed by the defendant either understandingly or otherwise. It was executed by Rosene, who had neither express nor implied authority from the defendant to bind it by such a contract, and who is alleged to have executed the contract as a part of a general scheme entered into with the plaintiff to defraud the defendant.

Aside from the fact that Rosene had no authority to execute the contract on behalf of the defendant, and therefore the contract never had any existence in fact, it is apparent that the fraud in this transaction was not a mere inducement for the company to execute the contract, but was a fraud inherent in the execution itself, and the case in that phase should be governed by the principle announced in *Insurance Co. vs. Bailey,* 13 Wall., 616. In that case the Insurance Company issued two policies on the life of Albert Bailey. After Bailey's death, the beneficiary brought suit upon the policies. The Insurance Company thereupon filed a bill in equity against the beneficiary under the policies, alleging that

the policies had been procured by the defendant by fraudulent suppression of material facts and misrepresentations of other material facts. It was alleged and evidence given tending to prove that while both Bailey and the beneficiary represented to the company that he was in good health, the fact was that he was suffering from a disease which proved fatal within a short time after the policies were issued, and that both Bailey and the beneficiary had been advised by his physician that he could not live more than six months. The court held that this was a defense available at law, and for that reason dismissed the suit in equity.

In *Life Insurance Company vs. Bangs,* 103 U. S., 780, suit had been brought upon a life insurance policy and a judgment obtained thereon. A bill was thereupon filed by the insurance company against the plaintiff in the judgment, seeking to enjoin its execution, upon the ground that the policy had been procured from the insurance company for the purpose of robbing that company, and by misrepresentations and fraud. It charged a conspiracy between the assured and his wife and son to take out this insurance, the insured intending shortly thereafter to commit suicide, which in fact he did, and charging that the beneficiaries in the policy had aided him in so doing. The court held that these facts were available as a defense at law in the suit upon the policy and the defense not having been made in that action, equity was without jurisdiction to enjoin the judgment.

See also *Buzard vs. Houston,* 119 U. S., 347.

That fraud is one of the subjects of concurrent jurisdiction in courts of law and courts of equity, is elementary. In such cases where an action at law has already been commenced and the fraud is of the character cognizable at law, a court of equity has no jurisdiction and the defense must be made in the action at law. Equity will interfere only where something more than mere defense is sought, as where full protection to the defendant requires injunctive relief or the cancellation of some instrument or some other distinctly equitable relief. (I. Pom. Jur., Sec. 179.)

Under the facts alleged in the plea in this case, the fraud was inherent in the very execution of the contract, in that the agent in the act of signing the contract on behalf of the defendant was carrying out and consummating the pernicious agreement made with plaintiff. As stated by Judge Lurton in the case of *City vs. Pertz,* 66 Fed., 427, 435:

"The conflict created between duty and interest is utterly vicious, unspeakably pernicious and an unmixed evil. Justice, morality and public policy unite in condemning such contracts and no court will tolerate any suit for their enforcement."

To permit a recovery, under such circumstances, would be against all sound principles of law and morals and against public policy.

In *Hartshorn vs. Day,* 19 How., 211, which is the

leading case announcing the principle contended for by appellant, the court stated that "fraud in the execution of an instrument has always been admitted in a court of law, as where it has been mis-read or some other fraud or imposition has been practiced upon the party in procuring his signature and seal. The fraud in this aspect goes to the question whether or not the instrument ever had any legal existence." Where a party secretly pays or agrees to pay an agent compensation or reward for signing the principal's name to a contract, knowing that the agent has no authority from the principal to sign such a contract, it seems too clear for argument that the signature of the principal is secured by fraud or imposition, within the rule stated in the *Hartshorn* case.

It is also beyond dispute that where a contract is voidable at the election of one of the parties, his repudiation and disaffirmance of the contract and notice thereof to the other party puts an end to the contract for all purposes, and no action can be obtained thereon thereafter either in law or equity.

It also seems to be beyond question under the authorities that where a contract made by an agent is voidable as to his principal, because of the relation of the agent to the other party or his adverse interest, the principal may repudiate or rescind the contract simply by notification to the other party that he repudiates or disaffirms it. Of course, if he has received anything

under the contract, he is required to return or tender a return of it. In this case the defendant had received nothing under the contract. The complaint did allege that defendant had made payment of part of the subscription and had received certain shares of stock thereon. The defendant, in the general denials in its answer, denied these allegations.

If the subscription contract was not absolutely void *ab initio* because of lack of authority in Rosene to make the subscription, there can be no question under the authorities that this adverse interest of Rosene, coupled with his relations to both corporations, made a contract entered into by him on behalf of the defendant with the plaintiff, at most, a voidable contract with respect to the defendant, and the timely repudiation of the contract by the defendant put an end to the contract entirely.

"A lawful rescission of an agreement by mutual consent, or from the action of one party alone, where by reason of fraud, duress or other legal ground for rescission the right is vested in him to elect to abrogate the contract, puts an end to it for all purposes."

Davis vs. Bronson, 50 N. W., 836.

"Where the defrauded party repudiates the contract, he can thereafter resist the enforcement of the contract, not only in a court of equity, but also in a court of law."

6 Rul. Cas. Law, Sec. 52.

"By rescission, the contract is annihilated so effectually that in contemplation of law it has never had any existence, even for the purpose of being broken.

6 R. C. L., Sec. 323.
Whitman Ag. Co. vs. Hornbrook, 55 N. E., 502.
14 Am. & Eng. Ency. Law, p. 158.

In any view of the case, the facts pleaded show a right in defendant to rescind the contract, and timely exercise of that right by defendant before this action was brought. Such a defense is legal, not equitable, and the case is not reviewable by appeal.

Respectfully submitted,

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